

UIL  
501.07-05

Internal Revenue Service  
District Director

Department of the Treasury

Person to Contact:

Telephone Number:

Date:

In our letter dated , your organization was held exempt from Federal income tax as an organization described in section 501(c)(7) of the Internal Revenue Code.

As a result of an examination of your activities and Form 990 for the year ending , it was determined that your organization is not operating within the guidelines of the rules and regulations of section 501(c)(7) of the Code. On you signed a statement which indicated that you were in agreement with revocation of your exempt status under section 501(c)(7) of the Code.

Therefore, effective your tax exempt status under section 501(c)(7) of the Internal Revenue Code is revoked. You are now required to file Federal income tax returns on Form 1120.

This is a final adverse determination letter with regard to your status under section 501(c)(7) of the Code.

If you have any further questions, please contact the person whose name and telephone number are shown above.

Sincerely,

Steven A. Jensen  
District Director

Proposed Revocation of Federal Tax Exempt Status  
Under Section 501(c)(7) of the Internal Revenue Code

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ISSUE

Should the tax exempt status under section 501(c)(7) of the Internal Revenue Code of \_\_\_\_\_ be revoked due to excessive nonmember income?

FACTS

\_\_\_\_\_ was granted Federal tax exemption under section 501(c)(7) of the Code in \_\_\_\_\_

The Club was organized to provide a social and recreational environment for the enjoyment and benefit of its members. The Club has no facilities but does hold meetings and generally congregates at \_\_\_\_\_. They also organize and provide opportunities for members to see games the \_\_\_\_\_ play at locations outside the \_\_\_\_\_.

Membership consists of individuals who are interested in the game of hockey and specifically the \_\_\_\_\_. Members are signed up in either of two methods. Members are contacted to join from the current membership list or new members are attracted at tables set up at each hockey game. Members are allowed to participate in all Club activities including trips for away games, picnics, awards banquet, and the Ladies Luncheon. There are also monthly meetings members can attend, and members receive the monthly newsletter, \_\_\_\_\_. This newsletter does contain a small amount of advertising.

As mentioned above, the club sets up tables at each home game of the \_\_\_\_\_. These tables are used for numerous activities including, informing members of club activities, selling raffle tickets, and selling other merchandise offered by the club. Since the hockey games are attended by the general public, several activities of the organization are targeted to the general public.

The members also sell programs for the \_\_\_\_\_ during home games. All receipts from these sales are deposited into their bank account after each game. These funds are given back to the Hockey Team twice a month and a commission check is sent back to the club once a month.

The Jersey Raffles are also ran from the table during home games. Jerseys are purchased from the Team Shop a few times per year. Tickets for the Jersey Raffles were also purchased by the club. All receipts from these sales are deposited into their bank account after each game. These funds are then used to purchase more jerseys or for other club activities. When the club draws a winner, that person receives a jersey.

The Form 990-T, Unrelated Business Income Tax Return is filed, by \_\_\_\_\_, reporting income from advertising, Jersey Raffles, Program Sales, and Ticket Sales.

Unrelated business income, as reported, does not include any receipts received from the picnics, awards banquet, and the Ladies Luncheon. They have not provided any evidence to proof these activities were limited to members. Since these activities are advertised at the tables set up at the games and in the newsletter, it could be assumed these activities would be attended by both members and nonmembers.

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The club also sells merchandise at the tables including pins, buttons, calendars, and other misc. items. The club has stated they also sell this merchandise at the club meetings. The sales from the tables and the sales from the meetings were not separated. Since these novelty items were sold at the games, nonmember income was received from these activities.

The club also excluded a portion of the Jersey Raffle sales from Unrelated business income. They excluded 1/3 of this income, with the assumption that this income was received from members. They have not provided any evidence to substantiate this portion of income is attributable to members.

Per review of financial information for Fiscal Year ending , a summary of the revenue sources received during the year is as follows:

Gross receipts.....	\$	-	%
Membership: Dues and assessments.....		}	
Trips.....		}	Raffles
(members).....		}	%
Nonmember income: Advertising.....		}	
Jersey Raffle.....		}	
Program Sales.....		}	
Ticket Sales.....		}	%
Member & nonmember fees (Source of funds unknown and undocumented):			
Picnic/Awards Banquet, and Ladies Luncheon..		}	
Gross Sales of merch.		}	%

Per inspection of the Fiscal Year Form 990 returns for the years ending , the percentages from each type of income would be similar to those of the Fiscal Year , shown above.

LAW

Section 501(c)(7) of the Internal Revenue Code exempts from Federal income tax:

"Clubs organized for pleasure, recreation, and other nonprofitable purposes, substantially all of the activities of which are for such purposes and no part of the net earnings of which inures to the benefit of any shareholder"

Regulation 1.501(c)(7)-1(b) states that solicitations by advertisement or otherwise for public patronage of its facilities is prima facie evidence that the club is engaging in business and is not being operated exclusively for pleasure, recreation, or social purposes.

Section 511 of the Code imposes a tax on the unrelated business taxable income (as defined in section 512) of organizations described in section 501(c)(7).

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Section 512(a)(3)(A) of the Code provides, that in the case of an organization described in section 501(c)(7) of the Code, the term "unrelated business taxable income" means the gross income (excluding any exempt function income), less the deductions that are directly connected with the production of the gross income (excluding exempt function income).

Section 512(a)(3)(B) of the Code provides that "exempt function income" means the gross income from dues, fees, charges, or similar amounts paid by members of the organization as consideration for providing such members or their dependents or guests, goods, facilities, or services in the furtherance of the purposes constituting the basis for exemption of the organization to which such income is paid.

Revenue Procedure 71-17, 1971-1 C.B. 683 was issued to provide guidelines for organizations described under section 501(c)(7) of the Code to determine the effect of gross receipts derived from the nonmember use of the organization's social or recreational facilities. The Revenue Procedure also describes the records required when nonmembers use a club's facilities and the circumstances which a host-guest relationship will be assumed. The thrust of the Revenue Procedure, as modified by Public Law 94-568 94th Congress, H.R. 1144, October 20, 1976, is to determine if an organization is operating for Nonexempt purposes or is subject to Unrelated business income tax.

Under the Revenue Procedure 71-17 and Public Law 94-568, an organization described under section 501(c)(7) of the Code is permitted to receive up to 35 percent of its gross receipts from a combination of investment income and receipts from nonmembers, so long as the nonmember income is not more than 15 percent of total receipts. If an organization has income in excess of the 35 percent and/or 15-percent limitations, exemption under section 501(c)(7) of the Code may be revoked.

Revenue Procedure 71-17 provides that revenues are considered to be received from a member, when the following situation(s) are applicable, and such income is NOT subject to the unrelated business income tax provisions:

- (1) Where a group of eight or fewer individuals, at least one of whom is a member, uses club facilities, it will be assumed for audit purposes that the nonmembers are the guests of the member provided payment for such use is received by the club directly from the member.
- (2) Where 75 percent or more of a group using club facilities are members, it will likewise be assumed for audit purposes that the nonmembers in the group are guests of members, provided payment for such use is received by the club directly from one or more of the members.

An organization must maintain the following records to substantiate that the above situations are applicable:

- (a) For groups of eight or fewer individuals with at least one of whom is a member, an organization must show that the group was comprised of eight or fewer individuals, that at least one participant is a member and the payment was received directly from a member.
- (b) For groups of which 75 percent or more are members, an organization must maintain adequate records to substantiate that 75 percent or more of the persons in the group were, in fact members of the club at the time of such use and that payment was received from a member(s).

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For all other occasions involving use by nonmembers, an organization must maintain books and records of each such use and the amount derived therefrom. The record must contain the following information:

- (A) The date;
- (B) The total number in the party;
- (C) The number of nonmembers in the party;
- (D) Total charges;
- (E) The charges attributable to nonmembers;
- (F) The total charges pay by nonmembers;
- (G) Where a member pays all or part of the charges attributable to nonmembers, a statement signed by the member indicating where he has been or will be reimburse for such use and, if so, the amount of reimbursement...

**CONCLUSION**

The Federal tax exempt status should be revoked beginning on since nonmember income has exceeded the limitations set forth in Public Law 94-568, 94th Congress, H.R. 1144.

As shown above, revenues from nonmember income is 71.7 percent of gross receipts. Nonmember income, as reported on Form 990-T, is understated and should include revenues from Picnics, Awards Banquet, Ladies Luncheon and Merchandise sales. The amount of revenues received from nonmembers is NOT known because did not maintain records that would identify if funds were paid by a member or a nonmember or if a host-guest relationship existed as defined in Revenue Procedure 71-17.

From briefly reviewing the Forms 990 and 990-T from fiscal years and the nonmember income appears to be consistent throughout its existence. The methods by which the Club operates is conducive to high levels of nonmember income. The nonmember income is used to either provide more benefits to the members and/or reduce the dues paid by members for the same amount of services.

Because of the amount of time and effort given to producing nonmember income, is not operating within the provisions of section 501(c)(7) which exempts "Clubs organized for pleasure, recreation, and other nonprofitable purposes, substantially of the activities of which are for such purposes and no part of the net earnings of which inures to the benefit of any private shareholder.

In summary, the Federal Tax exempt status of is to be revoked effective For tax years beginning , must file Form 1120, U.S. Corporation Income Tax Return.